



Supreme Court of the United States

OCTOBER TERM, 1945.

No. .

PAUL H. SMART,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

Question Presented, Statement of Case, Statutes, etc.

The statement of the question presented, the statement of the case, and the statutes involved will be found in the petition.

Specifications of Errors and Summary of Argument.

I. The Circuit Court of Appeals erred in holding that corpus commissions paid to a New Jersey testamentary trustee in 1941 for services rendered from May 21, 1933 to October 7, 1940, did not constitute total compensation for personal services within the meaning of Section 107 of the Internal Revenue Code as amended by Section 139 of the Revenue Act of 1942. Such decision is directly contrary in principle to the decisions of the Supreme

Court involving the recognition to be accorded the local law in applying a revenue measure.

II. An important and substantial question of Federal law is involved which has not been, and should be, settled by the Supreme Court.

POINT I.

The Circuit Court of Appeals erred in holding that corpus commissions paid to a New Jersey testamentary trustee in 1941 for services rendered from May 21, 1933 to October 7, 1940, did not constitute total compensation for personal services within the meaning of Section 107 of the Internal Revenue Code as amended by Section 139 of the Revenue Act of 1942. Such decision is directly contrary in principle to the decisions of the Supreme Court involving the recognition to be accorded the local law in applying a revenue measure.

In 1941 the petitioner, as co-trustee, received \$73,197.93 as his one-half ($\frac{1}{2}$) share of corpus commissions for services rendered from 1933 through 1940.

The allowance was made upon the application of the petitioner in the course of an intermediate accounting before the Prerogative Court of the State of New Jersey. Proof of the services was submitted to the Court in affidavit form (R. 50-61). The application was contested by the life tenant and the substituted trustee (R. 63). After hearing and deliberation by the Court the objections were over-ruled and the allowance was made and incorporated in the Decree in the following language:

"It is further ordered that there be allowed to Paul Smart and Gladys B. Willets, administratrix of the

estate of Josiah Macy Willets, deceased trustee the sum of One Hundred Forty Six Thousand Three Hundred Ninety Five and 87/100 Dollars (\$146,395.87) as commissions on corpus *for services rendered* by Paul Smart and Josiah Macy Willets, from May 21, 1933, the date on which said trust was set up, until October 7, 1940" (R. 64). (Italics ours.)

The same Decree approved and allowed income commissions to the trustees at the statutory rate of five percent (5%) on income collected (R. 65).

The New Jersey Revised Statutes, Title 3:11-1 and 3:11-2 the relevant portions of which are printed at page 19 of the appendix provide that a trustee shall receive five percent (5%) on all the income and "may take such income commissions as of the time when the income was or is received by them without allowance thereof by the Court".

With respect to the payment of corpus commissions the statute reads:

"3:11-1. Corpus Commissions in General. Allowance of corpus commissions to Executors, Administrators with the will annexed, Guardians and Trustees under a will, shall be made with reference to their actual pains, trouble and risk in settling the estate, rather than in respect to the *quantum* of the estate."

Section 2 of the same act provides:

"Where the corpus receipts exceed Fifty Thousand (\$50,000.00) the Court before which the account shall be presented for settlement and allowance shall determine the corpus commissions of Executors, * * *, and Trustees under a will, on the intermediate or final settlement of their accounts according to the *actual services rendered*. * * *." (Italics ours.)

The State of New Jersey has outlined a comprehensive scheme for compensation to trustees. It recognizes that two types of services are rendered, one in connection with collection of income and the other in connection with the administration of corpus. It provides a definite measure of compensation for each type of services; for services to income, five percent (5%) of the income collected when it comes into the hands of the trustees without Court order; for services to corpus, the value of the actual services rendered, to be determined by the Court before whom the application is made and to be paid only upon direction of the Court.

The taxing statute is clear and unambiguous and was enacted to relieve taxpayers who work for extended periods of time and receive their compensation in a lump sum (Rept. of the Senate Finance Comm. No. 648, 76th Congress, 1st Sess.). It states, with respect to the tax year 1941, that if a taxpayer receives at least seventy-five percent (75%) of the total compensation for personal services rendered covering a period of sixty (60) calendar months or more he may allocate the payment so received over the period in which the work was performed and compute his tax at the rates prevailing over that period.

The Tax Court recognized that two types of services were rendered by the petitioner (R. 20) but in applying the taxing statute to the case of a testamentary trustee held in effect that "personal services" meant personal services both for administering principal as well as collecting income and that "total compensation" meant the total of all compensation for both types of services. The Tax Court further held that it was immaterial upon what basis the corpus commissions were allowed by the State Court (R. 22). In an earlier case, *Additon v. Comm.*, 3 T. C. 427, the Tax Court had held that the "services" re-

ferred to in Section 107 signified those services for which the compensation in question were paid.

The Court below did not accept the reasoning of the Tax Court and said that the case turned on whether the services for which the corpus commissions were awarded were separable from those for which the income commissions were awarded, and concluded that "although the question is not free of doubt in the absence of some authoritative ruling to the contrary, we think that unless the State Court bases its award of commissions upon income and principal upon a corresponding separation of services, in applying Section 107 both payments should be brought into a hotchpot and the prescribed percentage computed accordingly."

The Court below makes no reference in its opinion to the controlling New Jersey statute. It brushes aside the entire judicial proceeding in the Prerogative Court of the State of New Jersey which included a hearing in open Court, the taking of proof of the services rendered, the application for an allowance for these services, the objection to the allowance and the Decree of the Court, and in the place of the actual proceedings held and the Decree therein rendered, the Court below has substituted its own interpretation of the judicial process of the State Court in the following language:

"When a court comes to award commissions to a trustee for his services, it does indeed divide the burden, because the services have inured to the benefit of both the life tenant and the remainderman, who for that reason ought to share the cost. But in so doing the court does not even impliedly try to separate the services into those which have benefited the income and those which have benefited the principal; on the contrary it divides the cost, either by some

rule of thumb, statutory or judge-made, or according to the supposed benefit, or in some other of the ways which courts are accustomed to measure the incommensurable."

The decision of the Court below disregards the legislative intent of the State of New Jersey fixing separate standards of compensation to trustees for two types of services and seems to render meaningless the judicial process of the New Jersey court which took proof of the services performed and awarded "commissions on corpus for services rendered by Paul Smart * * * from May 21, 1933 * * * until October 7, 1940" (R. 64). That this compensation relates only to services to corpus is evident from the fact that separate compensation for collecting income for different periods of time is allowed in a further portion of the Decree (R. 65).

The local court did indeed divide the burden of compensation between the life tenant and remainderman but it also determined the separate value of the separate services to corpus in accordance with the settled rule that corpus commissions are measured directly by the value of the services rendered to corpus. *Babbitt v. Fidelity Trust Co.*, 72 N. J. E. 745; *In re Account of New Jersey Title Guarantee and Trust Company*, 76 N. J. E. 293.

In the *Babbitt* case, *supra*, the Court said with respect to corpus commissions at page 761:

"* * * where a trustee has a very large estate, such as this one was, of a most varied character, handed over to it, and is required by the rule, applied to it by the Court, to exercise due diligence in the calling in of all unauthorized investments, and the duty of investing in authorized securities, it should be paid

a proper sum to compensate it for this labor and the responsibility and risk involved."

In *New Jersey Title Guarantee and Trust Company, supra*, the trustee served for seven (7) years but no corpus commissions were allowed for failure to establish any demonstrable service rendered to corpus.

We respectfully submit that the decision below should be reviewed by this Court and a Writ of Certiorari should be issued because the decision of the Court below is in error and conflicts with the rule laid down by the Supreme Court that the interpretation of the local laws should be left to the local courts and that a taxing statute of the Federal Government must give effect to the local laws and the decree of the local court (*Blair v. Comm.*, 300 U. S. 5; *Helvering v. Stuart*, 317 U. S. 154).

POINT II.

An important and substantial question of Federal law is involved which has not been, and should be, settled by the Supreme Court.

The question presented affects every testamentary trustee in the State of New Jersey as well as testamentary trustees in the several states of the union. It raises an important question in the orderly administration of the revenue law for the Court below has expressed doubt and uncertainty as to the proper application of the law, in the absence of an authoritative ruling. The question has been passed upon only in the case at bar and in *Civiletti v. Comm.*, 3 T. C. 1274, affirmed 152 Fed. 2nd 332. In view of the uncertain state of the law, prolific litigation will ensue before the Tax Court and in the various circuits to determine the proper application of the

taxing statute to the compensation received by testamentary trustees.

In the *Civiletti* case the taxpayer was a testamentary trustee acting under the laws of the State of New York. He received a lump sum principal commission payment in 1940 and contended that he was entitled to the benefits of Section 107 of the Internal Revenue Code as originally enacted.

The amendment involved herein differs from the original act in that it changes the prescribed period over which the work is to be performed, reduces the permissive percentage that may be paid on account and eliminates the requirements contained in the original act that the compensation shall be received on completion of "such services".

The Tax Court in the *Civiletti* case held that the "total compensation for services rendered" within the meaning of the taxing statute included both principal and income commissions and that the income commissions heretofore received by the taxpayer were payments on account which exceeded the permissive percentage. The Tax Court considered it unnecessary to determine whether the services were completed.

The Tax Court considered that the decision in the *Civiletti* case was controlling upon the instant case.

Inasmuch as payments of corpus or principal commissions are episodic and necessarily cover work performed over an extended period of time and income commissions are paid to or retained by trustees without an accounting upon income collected at regular intervals, the fiduciary, under the reasoning of the Tax Court, except in isolated cases, can not avail himself of the benefits of the taxing statute because the aggregate of the income commissions, if considered payments on account, would exceed the per-

missive percentage. The reasoning of the Tax Court would seem contrary to the rule of this Court that a taxing statute should be construed to effect equality among all taxpayers of a class (*Colgate-Palm-Olive-Peet Co. v. U. S.*, 320 U. S. 422, 425, 429). There is no distinction between an individual fiduciary and any other person who renders personal services (*Clark v. Comm.*, 3 T. C. 676).

The Circuit Court of Appeals in reviewing the decision of the Tax Court in the *Civiletti* case did not refer to or apparently consider the payment of income commissions as a factor in the case. It denied relief to the petitioner on the ground that the services had not been completed at the time the compensation was received which it said was a necessary requirement under Section 107 as originally enacted. It seems to hold that in a case coming under the present amendment a New York testamentary trustee could avail himself of the benefits of the statute and said "it would indeed be reasonable to allow the exemption to any taxpayer who receives in one sum the payment for five (5) or more years' services and that is just what Congress did when it amended Section 107 by Section 139 of the Revenue Act of 1942".

In the instant case which involved the amendment the Court below denied the exemption to the petitioner although it would seem that under the language quoted above the Court should have held to the contrary. In view of the remedial purpose declared by the Court below to underly the statute and in view of its own doubt, the Court below was in error for the Supreme Court has said that a tax law "is to be construed liberally in favor of the taxpayers to give the relief it was intended to provide" (*Bonwit Teller & Co. v. U. S.*, 283 U. S. 258, 263) and that "if the words are doubtful that doubt must be resolved against the government and in favor of the tax-

payer" (*U. S. v. Merriam*, 263 U. S. 179, 188). *Slough et al. v. Comm.*, 147 Fed. (2nd) 836 (C. C. A., 6th Cir.).

The *Civiletti* case and the instant case involve testamentary trustees who performed substantially identical services and who received principal or corpus commissions after an extended period of time during which they received income commissions in excess of the permissive percentage. In the instant case the Court below considered receipt of income commissions as a payment on account of total compensation and therefore dispositive of the issue presented; in the *Civiletti* case the Court did not consider the income commissions at all. It would seem difficult, if not impossible, to reconcile the two decisions and develop a rational basis to serve as a guide for the proper application of the taxing statute to the case of trustees.

We respectfully submit that the decision below should be reviewed by this Court and a Writ of Certiorari should be issued because the question involved affects all testamentary trustees qualified and acting under the laws of the several states and is of importance in the orderly administration of the Internal Revenue laws and should be authoritatively settled by this Court. *Helvering v. National Grocery Co.*, 304 U. S. 282; *Interstate Transit Lines v. Comm. of Int. Rev.*, 319 U. S. 590; *Riggs v. Del Drago*, 317 U. S. 95.

CONCLUSION.

For the foregoing reasons it is respectfully submitted that the Petition for Writ of Certiorari to the Circuit Court of Appeals for the Second Circuit should be granted.

Respectfully submitted,

JULIUS L. NEIDLE,
Counsel for Petitioner.

